

Audit overview

Since 1992, Victorians have been paying the Municipal and Industrial Landfill Levy (MILL) when they dispose of waste to landfill. The levy aims to encourage recycling by putting a price on every tonne of waste that goes to landfill.

Since 2005, approximately \$1.7 billion has been collected through the levy. These proceeds are used first to fund core activities of environmental agencies, with the balance being transferred to the Sustainability Fund (the fund) that was established in 2005.

The fund was established under section 70 of the *Environment Protection Act 1970* (the Act). It is a hypothecated trust account and as such under the Act, payments from the fund can be made only for the purposes of fostering:

- environmentally sustainable uses of resources and best practices in waste management
- community action or innovation in relation to the reduction of greenhouse gas substance emissions, or adaptation or adjustment to climate change in Victoria.

Good financial management and transparency is particularly important for trust account expenditure.

The Department of Environment, Land, Water and Planning (DELWP) administers the fund and provides support to the Sustainability Fund Committee (the committee) set up by the Minister for Energy, Environment and Climate Change (the minister) to support the strategic and accountable management of these trust monies. The Sustainability Fund team (the team)—established within the Finance and Planning division of DELWP—provides secretariat support to the committee, along with finance and administration support for the MILL and the fund.

The committee's role is to provide impartial, strategic advice to the minister regarding allocations from the fund. Consent from both the Premier and the minister is required before money is committed to a project designed to pursue one of the fund's legislative purposes.

Fund recipients are responsible for the delivery of projects.

We audited five agencies that are involved with the collection of the MILL, administration of the fund and/or are recipients of its funding:

- DELWP
- Environment Protection Authority (EPA)
- Sustainability Victoria (SV)
- Metropolitan Waste and Resource Recovery Group (MWRRG)
- Gippsland Waste and Resource Recovery Group (GWRRG).

A hypothecated trust account holds money collected from a specific levy for a particular purpose.

Such accounts form part of the Trust Fund under section 19 of the *Financial Management Act 1994*.

Throughout the report we refer to 'proposals' to describe what the committee provides advice on, 'programs' to describe what the minister and Premier ultimately approve and then 'projects' to refer to project management after their approval and once funding agreements have been established.

We focused on the financial management of the MILL and the fund, processes for prioritising and selecting programs funded from the fund, project management and outcomes of funding.

Conclusion

While we found that MILL distributions to environmental agencies and the transfer of the remaining balance to the fund accord with the Act, there is a potential risk that the MILL, and the fund, are not always used for their intended purposes, and that activities that receive fund monies are not achieving the legislative objectives of better waste management, reduced greenhouse gases or effective adaptations to climate change. This is because:

- there is no process to ensure that agencies that receive MILL funding under section 70E(3)(d) of the Act spend this money in line with legislative objectives
- committee advice to government on the eligibility and merit of proposals to fund is incomplete and inconsistent, limiting the ability of the minister to make informed decisions that allow full comparison between competing proposals
- the construct of the committee, which includes senior staff of DELWP—the main funding beneficiary—creates an inherent conflict of interest
- the lack of a formal process to ensure the committee considers proposals by departments other than DELWP, or that change significantly after feedback from the Expenditure Review Sub-Committee (ERSC), means proposals can bypass the requirement for committee assessment, as occurred in 2017–18
- there is a significant lack of evaluation of funded activities and public reporting on fund outcomes.

DELWP recognises these design and implementation issues and has taken steps to resolve them, such as ensuring all 2018–19 proposals to the fund received committee appraisal; establishing an evaluation framework; and releasing an activity report in May 2018 and committing to its annual publication. The minister has also recently approved changing the membership of the committee to make it fully independent.

These developments if sustained will help foster greater public trust and confidence in the rationale for the fund and the ability of DELWP to administer it effectively.

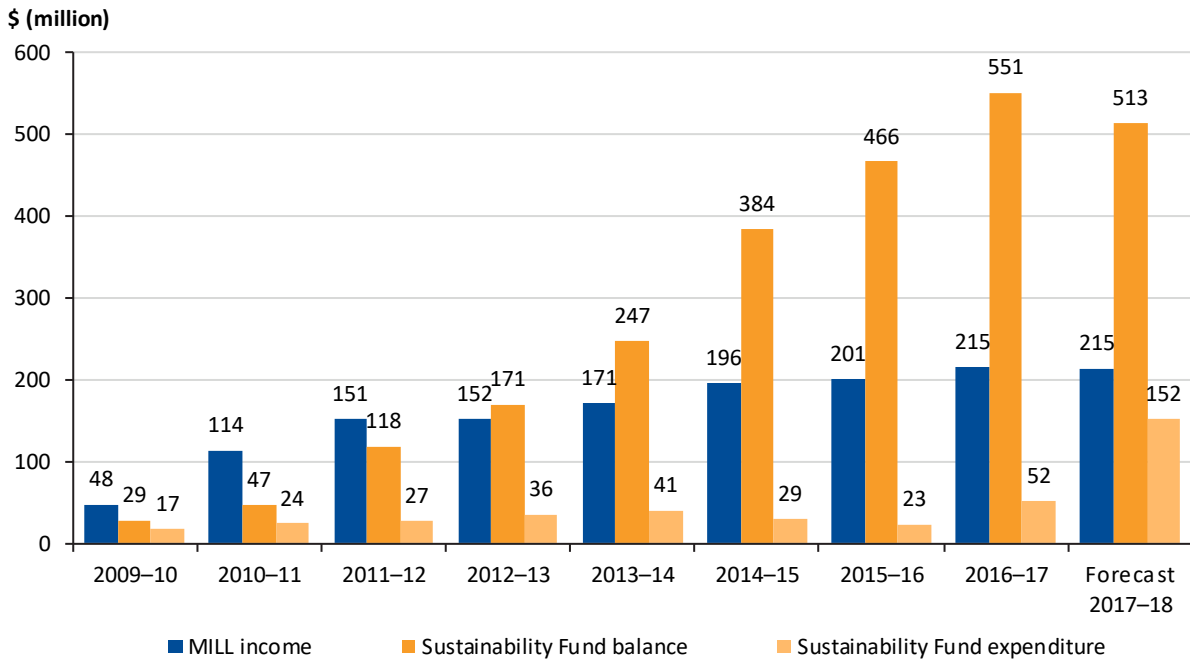
However, a significant proportion of funds have remained unspent over many years, representing an opportunity cost. The 2016–17 and 2017–18 State Budget (Budget) commitments will only reduce the balance of the fund in the short term. If the situation persists, where significant fund balances remain unspent over extended periods, the public may by extension, reasonably question the quantum of the charge on every tonne of waste that goes to landfill.

Fund balances

As at 31 December 2017, the balance of the fund was \$562 million. DELWP expects this to be \$513 million by 30 June 2018. The balance of the fund was \$29 million in 2009–10. As noted below, actual and budgeted expenditure has significantly increased over the past two years, however, the balance of the fund is predicted to remain high. To date, government has made no public commitment, nor outlined a strategy or target to reduce this balance.

Since 2009, \$401 million has been distributed from the fund—48 per cent of the \$829 million that has been transferred into it over this period. Figure A shows the growth of the fund since 2009 compared to the total of MILL income raised.

Figure A
MILL income compared with fund growth



Source: VAGO.

MILL distributions

Over the past three years, MILL payments to environmental agencies have increased by 71 per cent—from \$76.1 million in 2015–16 to a forecasted \$130.5 million in 2017–18. This increase is primarily due to EPA reform funding. Over the next four years, the MILL is expected to collect approximately \$215 million a year.

The minister determines the amount to be paid, the timing of payments and period over which they apply. Increasing direct payments from the MILL reduces the amount transferred into the fund.

In 2014, the Act was changed to include section 70E(3)(d). This allows public entities, in addition to those identified in section 70E(3), to be funded from the MILL for 'environment assessment, protection, restoration or improvement purposes'. Funding under this section of the Act increased from \$5.9 million in 2015–16 to \$24 million in 2017–18, with Parks Victoria (PV) being the primary recipient.

Currently DELWP policy areas suggest to the minister possible programs to be funded under this provision. There are currently no guidelines or governance processes to inform or evaluate the use of this funding from the MILL and to ensure it meets the conditions of section 70E(3)(d). Although the 22 committees of management that receive funding under section 70E(3)(d) provide financial acquittals to DELWP, PV and the Commissioner for Environmental Sustainability (CES) do not—despite accounting for over 95 per cent of the expenditure under this provision. Where the team has concerns about the alignment of a distribution it has sought legal advice. However, it has no formal responsibility to oversee these distributions. Monies paid from the MILL under this provision are not consistently subject to a financial acquittal, meaning most agencies are not required to demonstrate whether they use these funds for the specific purpose provided.

Fund program expenditure

Fund distributions have varied over time depending on government policy and priorities. Over the past two years, budget commitments from the fund have been at their highest levels since the fund was established.

Government distributed \$52 million from the fund in 2016–17 and committed to spend \$152 million in 2017–18. The 2017–18 Budget provides for fund expenditure of \$439 million in new funding over five years between 2016–17 and 2020–21. However, the government has recently announced an allocation of only \$32.7 million from the fund in its 2018–19 Budget.

The government established the MILL to incentivise waste resource recovery and reprocessing and put a price on every tonne of waste that goes into landfill. At that time the fund was designed to fund programs that foster best practices in waste management. China's recent restriction on recycling material highlights the need for the government to consider how best to address this issue. In February 2018, the Victorian Government announced a \$13 million support package for councils and industry affected by this issue. The government intends to resource this from the fund.

Investment and administration

DELWP has minimised administrative overheads and maximised returns on the cash balance of the fund.

DELWP investment of the cash balance of the fund is consistent with government legislation and policies. DELWP uses the Sustainability Fund Investment Policy (SFIP) to guide its investment decisions. Investment returns are consistent with expectations and interest earnings are retained within the fund.

The cost of administering the scheme has remained constant despite a significant increase in the work associated with this role. The activity of the team and committee has increased as the value and number of programs approved for funding from the fund has gone up. The administrative budget has not significantly changed for several years—it has remained at \$0.8 million.

Role of the committee

The committee plays an important role assessing proposals seeking monies from the fund. It provides advice to the minister to assist in the selection and approval of proposals, including advice about their eligibility and merit.

Since its establishment in 2016 the committee has identified issues with, and made changes to improve its engagement with potential funding recipients, project establishment and oversight, assessment methodology and processes, and program evaluation.

However, more needs to be done. There is an opportunity to further strengthen the committee's advice by:

- providing them with access to all proposals seeking funding from the fund prior to ministerial consideration
- removing conflicts of interest
- clarifying guidance
- more clearly and completely documenting how each proposal performs against the evaluation criteria in the advice to the minister.

Regular and alternative approval pathways

In 2017–18 the committee did not provide advice on all proposals that were funded. This was a breach of the statutory *Sustainability Fund Guidelines* (the Guidelines) which require the minister and Premier to seek advice from the Sustainability Fund Manager or committee prior to approving the use of fund money. The committee did, however, provide advice for all 2018–19 Budget proposals recommended to be approved from the fund.

There is no process to ensure the committee has access to all proposals prior to their consideration by government. In the 2017–18 Budget process only eight of the approved programs (representing 53 per cent of the value of those approved) went through the 'regular' pathway, which includes committee assessment. The remaining six programs went through one of three other possible approval pathways. This prevented the committee from reviewing, rating and providing advice to the minister on proposals prior to ERSC, which considers proposed expenditure as part of the Budget process.

Of the eight programs that followed the regular pathway, the committee rated one program and a component of another as needing 'more information'. This rating, at the time, was used interchangeably to refer to bids that required more information to enable assessment as well as those the committee assessed as not aligned with the legislation, as there was no 'do not support' advice option in 2017–18. Further, the committee did not give any rating to one component of another proposal. This means that the committee only assessed against evaluation criteria, rated and provided advice to the minister on four out of the 14 programs approved for funding in 2017–18.

The two highest value bids announced in the 2017–18 Budget, to receive funding from the fund, were Timber Plantation Establishment and Protecting Victoria's Environment—Biodiversity 2037. The committee did not review the Timber Plantation Establishment program before ERSC endorsement and it rated the Protecting Victoria's Environment—Biodiversity 2037 program as needing 'more information'. Expenditure for these programs has been committed in the 2017–18 Budget and the minister and Premier have approved funding for the biodiversity program. Further information regarding the alignment of the Timber Plantation Establishment program's legislative objectives needs to be provided before the minister and Premier approve expenditure from the fund.

For the 2018–19 Budget, the committee rated the Port Phillip Bay Beach Renourishment program 'not currently supported' because it did not align with the legislative objectives of the fund. The 2018–19 Budget announced funding for this program from the fund, but at that time the minister and Premier had not yet provided final approval for release of the funds. DELWP has advised that these proposals are now not being put forward for approval from the fund.

Due to the nature of the budget process, the committee does not always assess the final version of proposals as they may continue to change right up until the time departments submit them to ERSC for consideration. DELWP is aware of the risk this situation creates to the integrity of the approval process and advised it is seeking endorsement from the minister and Premier for a formalised system to ensure the committee reviews and provides advice on all future bids before the minister and Premier approve them.

Conflict of interest

One outcome from the 2013 *Report of the Ministerial Advisory Committee on Waste and Resource Recovery Governance Reform* was the transfer of fund management from SV to DELWP. The report found a perceived conflict of interest in SV's role as the administrator of the fund and being one of its primary funding recipients.

DELWP is now the primary recipient of funding from the fund, receiving \$354.13 million or 79 per cent of active program funding, though a proportion of this funding is passed on through grant programs. Two of the five Sustainability Fund Committee members are DELWP employees responsible for policy areas that benefit from funding. As committee members they are also involved in assessing and providing advice on their own budget proposals.

The committee has attempted to address these conflicts through a conflict of interest policy and procedures that require members to disclose conflicts and decisions made on how they should manage them. These controls are not sufficient to address the inherent conflict of interest created by the current membership of the committee. DELWP recognises this is an issue that needs to be resolved. The minister has recently approved an update of the Guidelines, as part of DELWP's response to the audit, to change the membership of the committee to make it fully independent.

Clarifying guidance

According to the Guidelines, proposals that seek funding for their core administrative costs are not eligible for funding from the fund. We reviewed all funding proposals the committee assessed in 2017–18 and found seven examples where, due to definitional ambiguities, there is a risk that the committee recommended proposals that may contain core administrative costs and may therefore be ineligible.

DELWP advised that these examples related to proposals that expand service provision into new areas and therefore do not represent core administrative costs. Our discussions with DELWP staff revealed that there is no documented definition of what constitutes core administrative costs. This highlights the need for an agreed definition of 'core administrative cost' and for the committee to apply this consistently in the assessment and recommendations for funding.

The Guidelines do not specify how to deal with proposals seeking ongoing funding or programs that are looking to shift their funding from output appropriations to the fund. Funding proposals may seek a fixed amount of funding for a period of the program, usually three to five years, plus ongoing annual funding beyond this period. DELWP advised that \$20 million in ongoing funding was approved in 2017–18 and it requested over \$80 million in ongoing funding as part of its proposals in the 2018–19 Budget process. The committee recognises that committing fund monies to projects on an ongoing basis could be an issue if, for example the demand, as demonstrated by the number and size of 2018–19 proposals, led to a significant decline in the fund balance. The committee noted in its advice to the minister that ongoing funding may limit innovation and the ability of government to ensure effective alignment of funded programs. It also noted funding for ongoing components could be made subject to a four-yearly evaluation to confirm alignment with the fund.

Committee assessments and advice

This year, for the first time, the value of proposals requesting funding exceeded the fund balance. The growing demand on the fund underlines the importance of providing clear and complete advice to the minister about each proposal's alignment with legislative objectives, and performance against all other evaluation criteria.

The committee rates each proposal as highly recommended, recommended, recommended subject to additional consideration, more information or not currently supported.

Five evaluation criteria (impact, quality, policy alignment, value for money and outstanding issues) inform the overall rating. However, the committee's assessment against each criterion is not included in their advice to the minister making it difficult for the minister to distinguish between the merits of each proposal.

The committee's assessments also do not consistently document consideration of alternative funding sources—a requirement in the Guidelines. In addition, the value for money assessment currently performed by the committee does not include enough information to enable the minister to determine which programs will most cost-effectively deliver on the fund's objectives. The value for money assessment included in a program's business case does not specifically consider the objectives of the fund and it is not clear how the committee uses this information in the assessment of proposals.

Committee advice also lacked sufficient detail to enable the merit of one proposal to be weighed against another; and also lacked clear and complete documentation about what proposals or proposal components may be ineligible for funding. The advice provided by the committee to the minister for different bids is inconsistent, which limits the minister's ability to fully compare and contrast bids when making funding decisions.

In addition, the committee requested more information on a number of proposals in 2017–18 which was not forthcoming prior to approval, meaning it could not make a complete assessment and fully advise the minister on particular projects to confirm alignment. These proposals were approved creating the potential risk that they may not be aligned with the fund's legislative objectives or represent the best application of fund resources.

The minister recently approved an update of the Guidelines to change the membership of the committee to make it fully independent, and to provide better clarity about the advisory function of the committee and the definition of core administrative costs.

Project delivery

Project delivery is hampered by delays in establishing project plans and funding agreements. Opportunities exist to better align the number of milestones attached to reporting and funds release with the complexity and value of funded programs. There is an opportunity for DELWP to clarify roles and responsibilities for escalation of underperforming projects.

Role of the team

DELWP directs the majority of the team's resources to managing funding agreements. The team has six staff, the Sustainability Fund manager, one financial analyst, one to support the committee and provide advice on proposals and three responsible for managing funding agreements.

The team's role during the various stages of project development and delivery is not clear, creating the potential for duplication of effort. Recognition should be given, where warranted, to the processes and mechanisms some recipients have in place to oversee the delivery of projects such as project control or independent boards who are appointed by and accountable to a minister.

Funding agreements

Following approval by the minister and Premier, funding recipients develop a project plan. The team assists as required with the development of project plans and funding agreements are developed once sufficient information is available for their completion. Recipients do not receive any money until the funding agreement is established.

We reviewed the time frames for establishing funding agreements for 16 projects from 2015 to 2018. DELWP took 213 days on average to develop a funding agreement from the point of program approval. One project took a year to establish a funding agreement after the minister and Premier approved its funding. Agencies stated that significant resources are required to develop the project plan and they absorb development costs until receipt of the first payment. Delayed establishment of project plans continues to be an issue that results in fund underspending. DELWP has advised that it aims to have project plans established by 30 June 2018 for programs approved in 2018–19 and have engaged consultants to assist with their development.

Funded projects are paid against achievement of project milestones. Our analysis of 49 funding agreements found that the average number of project milestones was 15, with the highest number for a single project being 71, and the lowest being three. There is no relationship between the number of milestones and the project cost or length. The rationale for some projects having significantly more milestones than others is not clear. Funding recipients raised concerns about the administrative burden of putting through requests for payments tied to each milestone. This illustrates the need for the team to be aware of this issue when developing funding agreements.

Monitoring

Funding agreements specify the monitoring, reporting and acquittal requirements for each initiative over the approved funding period. The team monitors and ensures recipients, with some exceptions, comply with these requirements. For example, recipients do not always provide their quarterly reports, however, where this occurs we saw evidence that the team follows this up.

Reporting

The fund's quarterly report provides the committee with the opportunity to review key aspects of project and financial management. Recipients are required to submit a quarterly progress report to the team but not all consistently comply with this requirement. According to the November 2017 quarterly report to the committee, 16 of the 56 project managers (29 per cent) had not submitted their most recent quarterly progress report. The team therefore could not accurately assess and report on the status of these projects.

DELWP recently aligned its internal management report and the committee's quarterly reporting. DELWP's report to its senior executive team now includes the status of funded programs delivered by DELWP, its portfolio agencies and DHHS. However, this report does not contain the progress of a project delivered by the Department of Treasury and Finance (DTF).

Escalation of project risks

DELWP should document a clear process for the management of underperformance or project risks for funded programs. Currently, the team raises project issues with the committee as part of its quarterly exception reporting. The exception report reviews and flags projects that may need attention or support. It raises any issues for escalation to the committee and identifies suggested committee actions. However, actions identified in these exception reports need to be clearer to ensure that the issues are being addressed. Committee meeting minutes from 14 November 2017 do not show that the committee discussed issues raised in the quarterly report or endorsed suggested actions to address the issues identified.

Financial acquittal

The team relies on the approval of the funding recipient's financial officer as evidence of financial acquittal. The team received a financial acquittal for all 17 projects that we tested. All include an expenditure report designed to include information on how funding was accounted for, what recipients spent funds on and what financial year they spent the funds in. The expenditure reports vary in the level of detail provided and may not always enable the team to confirm that recipients use the funds for their intended purpose.

Funding outcomes

Evaluation

DELWP has not been able to demonstrate the extent to which funded initiatives achieve their intended outcomes. As part of the audit, we reviewed the 18 projects that have closed in the past two years and found that all of them completed a project evaluation. The team completes a closure report that assesses the evaluation, where available, to determine whether closed projects have met their objectives.

Of the 18 projects we reviewed, only seven (39 per cent) reportedly met their objectives. Only two of the other 11 projects relate to programs that commenced during DELWP's administration of the fund. One of these programs was terminated early. The other was designed to achieve long-term behaviour change, and its outcomes have not yet been able to be assessed.

DELWP has worked to make project outcomes clearer in funding agreements with the aim of improving project evaluations on completion. DELWP has recently developed an evaluation framework to support a whole of fund evaluation and advises that this will be detailed in a 2017–18 activity report due to be released alongside the DELWP annual report.

Lessons learned

DELWP currently does not have a formal process to capture and share lessons learned from completed projects. It intends to embed these lessons into the recently developed evaluation framework. The team captures lessons learned as part of the Final Evaluation Report but these are not stored in a central location. This means they are not easily accessible to the committee when new but similar proposals come up for assessment. The current process relies on the knowledge of the team or the committee members. The team does not currently share this information with funding recipients to allow this to inform future program development.

Overall fund outcomes

DELWP does not measure overall fund outcomes. The legislation and *2016 Sustainability Fund Priority Statement* (Priority Statement) provide broad objectives for the fund but DELWP does not use these to evaluate the success of the use of fund monies. The committee advised that a recently developed evaluation framework will support a whole of fund evaluation, which it intends to complete every four years. However, DELWP has not applied the framework to any projects to date, and it is not clear how this will work in practice.

Public reporting

DELWP has not publicly reported on the overall fund outcomes since it took over administration of the fund.

It is unclear how funded programs have contributed to the achievement of the fund's legislative purposes and the extent to which, if any, they have addressed the challenges posed by waste and climate change.

Until May 2018, public reporting about the activities of the MILL and the fund was limited to appendices to DELWP's annual report and general information on their website.

DELWP has recently published an activity report for 2015–17, *Investing in a more sustainable future*. The report was released in May 2018. It is similar to the report produced by SV. It is unclear why it has taken DELWP nearly two years to produce it. The delay in its publication affects its relevance and usefulness as a tool to improve the transparency of the fund and its management. DELWP advised it intends to publish an annual activity report each September after the close of the financial year. This process will be aligned to the annual reporting process. There has been no reporting of the fund’s governance arrangements.

It is important for the public to understand not just how this money is being spent, but also the extent to which it has been used to achieve its intended outcomes. There is a lack of transparency about the activities and outcomes of the fund. This undermines public trust in the collection of the levy.

There has been improved financial transparency about the fund in Budget Papers since 2016–17. They now more clearly identify programs that receive monies from the fund.

Recommendations

We recommend that the Department of Environment, Land, Water and Planning:

1. assess alignment with the legislative purpose and establish a financial acquittal process for distributions made under section 70E(3)(d) of the *Environment Protection Act 1970* (see Section 2.3)
2. establish an independent committee to manage inherent conflicts of interest while maintaining access to subject-matter expertise (see Section 3.5)
3. review the role of the Sustainability Fund Committee and Sustainability Fund team:
 - revise and update the committee’s terms of reference (role and responsibilities, memberships, managing conflicts of interest, +/- KPIs, rules for decision-making)
 - clarify the role of the team and the committee in the oversight of project delivery (see Sections 3.5 and 4.2)
4. develop clear guidance regarding the treatment of the following:
 - applications seeking core administrative costs
 - eligibility of applications seeking ongoing funding (see Section 3.3)
5. establish processes to ensure all proposals seeking funding from the Sustainability Fund are assessed by the Sustainability Fund Committee before approval by the Minister for Energy, Environment and Climate Change and the Premier (see Section 3.4)
6. review the evaluation criteria applied to assessing proposals to clearly reflect the requirements specified in the legislation, *2016 Sustainability Fund Priority Statement* and *Sustainability Fund Guidelines* (see Section 3.2)

7. improve the quality of advice provided to the Minister for Energy, Environment and Climate Change by providing the assessment against each evaluation criteria (see Section 3.5)
8. relate the number of funding agreement milestones to the value and/or complexity of funded programs and link payment milestones to reporting requirements to minimise administrative burden (see Section 4.2)
9. examine mechanisms to encourage the earlier development of project plans for approved programs (see Section 4.2)
10. require funding recipients to provide key categories of expenditure in support of the financial acquittal of funding agreements to enable the Sustainability Fund team to review whether the funds have been used for the purpose intended (see Section 4.2)
11. implement the evaluation framework to evaluate outcomes of funded programs to clearly demonstrate the extent to which programs have contributed to the specified legislative objective (see Section 4.6)
12. identify overall Sustainability Fund outcomes to measure the extent to which expenditure has successfully delivered legislative objectives (see Section 4.6)
13. develop a formal process to consistently apply lessons learned including:
 - capturing and storing them centrally to enable them to be considered by the Sustainability Fund Committee when assessing proposals
 - sharing them with agencies to enable them to be considered when developing new program proposals (see Section 4.7)
14. publish an annual public report for 2018–19 and future years detailing the activities of the Sustainability Fund and outcomes achieved (see Section 4.8).

Responses to recommendations

We have consulted with DELWP, EPA, SV, MWRRG and GWRRG and we considered their views when reaching our audit conclusions. As required by section 16(3) of the *Audit Act 1994*, we gave a draft copy of this report to those agencies and asked for their submissions or comments. We also provided a copy of the report to the Department of Premier and Cabinet (DPC).

The following is a summary of those responses. The full responses are included in Appendix A.

DELWP accepted all 14 recommendations and provided an action plan to address them. SV welcomed the audit and looks forward to supporting DELWP to address the recommendations. The two waste and resource recovery groups (WRRG) noted that the audit was consistent with their past experience as Sustainability Fund recipients and were supportive of the recommendations.